Supreme Court, U. S.
FILED
NOV 15 1979
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1979
No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,

Petitioner,

vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,

Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

BRIEF FOR THE PETITIONER.

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
1600 One Wilshire Building,
Los Angeles, Calif. 90017,
Attorneys for Petitioner.

THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

SUBJECT INDEX

Page

Opinions Below 1

Jurisdiction 2

Question Presented 2

Constitutional Provisions and Statutes Involved 2

Statement of the Case 3

Summary of Argument 7

Argument 11

I

The Commerce Clause Permits California's Property Tax to Favor Foreign Commerce Over Interstate Commerce 11

A. The California Inventory Tax Structure .. 11

B. The Constitution Permits a State to Place Local Business at a Disadvantage 11

C. The Commerce Clause Is Directed at Prohibiting Discrimination in Favor of Local Business at the Expense of Interstate Commerce 13

D. The Boston Stock Exchange Decision Is Distinguishable From the Instant Case, Was Misconstrued by the Lower Court, and Supports the Validity of the California Statute 14

E. The California Statute Is Consistent With Constitutional Policies Articulated in the Michelin Decision 18

Page

F. Federal Policy Encourages States to Favor Foreign Commerce Over Interstate Commerce 19

II

The Exemption Accorded Imported Goods Did Not Frustrate Congressional Power in Establishing Tariffs 21

III

The California Statute Should Be Upheld Because No Impermissible Effect Upon Commerce Has Been Established 23

A. The Lower Court Erroneously Applied a Per Se Test in Determining the Statute's Constitutionality 23

B. Respondents Failed to Establish That the Statute Has Any Effect on Interstate Commerce 25

C. The Effect of the Statute, if Any, Is too Insubstantial to Place an Undue Burden on Interstate Commerce 27

Conclusion 29

Exhibit A. Pertinent State Statutes Involved 1

TABLE OF AUTHORITIES CITED

Cases Page

Alaska v. Arctic Maid, 366 U.S. 199 (1961) 8, 12

Allied Stores v. Bowers, 358 U.S. 522 (1959) 8, 12

Boston Stock Exchange v. State Tax Commission, 429 U.S. 318 (1977) 7, 8, 9, 14, 15, 16, 17, 18, 28

Brown v. Maryland, 25 U.S. (12 Wheat.) 262 (1827) 3, 25

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 10, 24, 25

Department of Revenue v. Association of Washington Stevedoring Cos., 435 U.S. 734 (1978) 27, 28

Dunbar-Stanley Studios, Inc. v. Alabama, 393 U.S. 537 (1969) 12

First Federal Savings and Loan Association v. State Tax Commission, 437 U.S. 255 (1978) 25, 28

Gregg Dyeing Co. v. Query, 286 U.S. 472 (1932).. 27

Guy v. Baltimore, 100 U.S. 434 (1879) 13

Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963) 13, 14

Hooven & Allison Co. v. Evatt, 324 U.S. 652 (1945) 3

I.M. Darnell & Son v. Memphis, 208 U.S. 113 (1908) 14

Japan Line, Ltd. v. County of Los Angeles, ... U.S. ....., 60 L.Ed.2d 336 (1979) 8, 18. 19

Page

Low v. Austin, 80 U.S. (13 Wall.) 29 (1872) 3, 4, 6

May v. New Orleans, 178 U.S. 496 (1900) 3

Metropolitan Casualty Ins. Co. v. Brownell, 294 U.S. 580 (1935) 25

Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976) 6, 8, 18, 19, 26, 27, 28

Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) 10, 12, 15, 25

Nippert v. Richmond, 327 U.S. 416 (1946) 14, 27

Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951) 24

Volkswagen Pacific, Inc. v. City of Los Angeles, 7 Cal.3d 48, 496 P.2d 1237 (1972) 4, 5

Welton v. Missouri, 91 U.S. 275 (1875) 14

Miscellaneous

California Assembly Bill 66, Chap. 1150, Sec. 7 (1979) 5

House of Representatives Report 91-601, 91st Cong., 1st Sess., 38 (1969) 20

Regulations

Code of Federal Regulations, Title 26, Sec. 154.2-1 (c) 20

Code of Federal Regulations, Title 26, Sec. 154.2-1 (d) 20

Rules

Rules of the United States Supreme Court, Rule 36 .. 1

Statutes

Page

California Constitution, Art. XII, Sec. 1 11

California Revenue and Taxation Code, Sec. 201 11

California Revenue and Taxation Code, Sec. 219 .... 5, 23

California Revenue and Taxation Code, Sec. 225 3, 5, 6, 7, 8, 9, 10, 11, 13, 14, 17, 18, 19, 20, 26, 28

California Revenue and Taxation Code, Sec. 401.3.. 11

Internal Revenue Code, Sec. 4271 8

Internal Revenue Code, Sec. 4272 8

Internal Revenue Code, Sec. 4272(a) 20

Public Law No. 91-258 20

United States Code, Title 28, Sec. 1257(3) 2

United States Constitution, Fourteenth Amendment 12

United States Constitution, Fourteenth Amendment, Sec. 1 2

United States Constitution, Art. I, Sec. 8, Clause 3 2

United States Constitution, Art. I, Sec. 10, Clause 2 2

Textbook

Keesling, Michelin Tire Corporation v. Wages: The Demise of the Original Package Doctrine, 50 So. Cal. L. Rev. 719, 725 (1977) 26

Maltz, The Burger Court, The Commerce Clause, and the Problem of Differential Treatment, 54 Ind. L.J. 165, 167 (1979) 15

IN THE

Supreme Court of the United States

October Term, 1979
No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,
Petitioner,

vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,
Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

BRIEF FOR THE PETITIONER.

Opinions Below.

The order of the trial court is not officially reported. The opinion of the Court of Appeal (Pet. App. 1-29)[1] is reported at 85 Cal.App.3d 763, 149 Cal.Rptr. 750 (1978). The denial by the Supreme Court of California of a petition for hearing (Pet. 2) is reported at 149 Cal.Rptr. 764 (1979).

[1]The Appendix attached to the Petition for Certiorari shall be referred to as "Pet. App." followed by the appropriate page numbers. The separate Appendix required by Rule 36 shall be referred to as "A." followed by page numbers. The Petition for Certiorari shall be referred to as "Pet." followed by page numbers.

Jurisdiction.

The decision of the Court of Appeal was filed on October 25, 1978 (Pet. 2; Pet. App. 1). The Supreme Court of California denied a petition for hearing on January 17, 1979 (Pet. 2). The petition for a writ of certiorari was filed on April 16, 1979. The petition was granted on October 1, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

Question Presented.

Does a California statute exempting from its property tax certain goods manufactured or produced outside the United States and imported into California for shipment outside the state violate the Commerce Clause of the United States Constitution?

Constitutional Provisions and Statutes Involved.

1. Article I, Section 8, Clause 3 of the United States Constitution provides: "The Congress shall have Power * * * To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;"

2. Article I, Section 10, Clause 2 of the United States Constitution provides: "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws; * * *"

3. Amendment XIV to the Constitution of the United States, Section 1, provides: "* * * No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor

deny to any person within its jurisdiction the equal protection of the laws."

4. California Revenue and Taxation Code, Section 225 provides: "Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property."

Statement of the Case.

The Commerce Clause challenge at issue here results from an evolution of constitutional doctrine beginning with *Low v. Austin*, 80 U.S. (13 Wall.) 29 (1872). There the Court held that the Import-Export Clause prohibited states from imposing an ad valorem property tax on imported goods until they lost their status as imports and became commingled with the mass of property in the state. In ascertaining whether imported goods retained their character as imports, the Court endorsed a principle which came to be known as the "original package doctrine," first articulated in *Brown v. Maryland*, 25 U.S. (12 Wheat.) 262 (1827). Under this doctrine imported goods which remained the property of the importer in his warehouse in the original form or package in which they were imported were immune from state taxation. *May v. New Orleans*, 178 U.S. 496 (1900); *Hooven & Allison Co. v. Evatt*, 324 U.S. 652 (1945).

One hundred years after *Low v. Austin,* the decision of the California Supreme Court in *Volkswagen Pacific, Inc. v. City of Los Angeles,* 7 Cal.3d 48, 496 P.2d 1237 (1972), triggered a series of events which led to this case. *Volkswagen* held that receipts of a wholesaler from the sale of goods imported in a shipping container or sea van taken to the importer's warehouse where it was opened and the goods removed for sale and delivery to dealers lost their immunity from a city license tax.

The assessors of many California counties interpreted *Volkswagen* as holding that a shipping container or sea van containing imported goods constituted the original package for the purpose of the original package doctrine, and that upon opening such container or sea van, the imported goods lost their immunity from ad valorem property taxes. The assessments made by such assessors on goods that had been considered immune for over 100 years since this Court's decision in *Low v. Austin, supra,* caused consternation among importers. *See* Report of the Research Department of the Security Pacific National Bank (A. 28-49).

Prior to *Volkswagen,* California's neighbor, Oregon, and many other states had enacted statutes exempting from their property taxes goods brought into such states for shipment to other states, including goods imported from foreign countries.[2]

From the report of the Research Department of the Security Pacific National Bank it is also clear

[2]Citations to these statutes are set forth in Exhibit "A" hereto. A Commerce Clearing House list of states with "free port" laws and a brief analysis of the provisions thereof are reproduced in Appendix A of Petitioner's Reply to Response to Petition for Writ of Certiorari.

that firms which imported goods in shipping containers considered the California ad valorem tax to be a *major* problem; that such firms were either changing their operations or making plans to do so by diverting imports to "free port" areas and by relocating part of their facilities outside the state. Furthermore, such firms were not expanding their facilities in California (A. 41).

Thus, as a result of the assessments made by California assessors based upon their questionable interpretation of the *Volkswagen* case, California was faced with substantial deterioration of its import business occasioned by the diversion of imports to other states where partial exemption from property taxes was assured by virtue of such states' "free port" statutes.

The California legislature in 1975 enacted a free port statute, Revenue and Taxation Code Section 225, which provides for an exemption from property taxation of goods purchased outside the United States and brought into California for shipment and sale outside the state. Section 225 also provides an exemption for goods brought into California from other states for shipment outside the United States, but it does not provide an exemption for goods produced in the state or for goods brought into California from other states for shipment within the United States.[3]

[3]Effective January 1, 1980, business inventories will be exempt from property taxation in California. Cal. Assembly Bill 66, Ch. 1150, § 7 (1979), amending Cal. Rev. & Tax. Code § 219. However, the 36 free port laws of states other than California are in jeopardy, based upon Respondents' assertion that a statute which treats interstate and foreign goods more favorably than local goods is invalid on Commerce Clause grounds (Respondents' Response to Petition for Writ of Certiorari, p. 5). Thus the issues raised herein are of importance not only to California but to some 36 other states as well.

Shortly after Section 225 became effective, this Court in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), held that imports not in transit were no longer immune from state ad valorem property taxes. The Court overruled *Low v. Austin's* prohibition on state taxation of imports in their original packages. Although California was thus free to impose an ad valorem property tax on such imports, California's free port law which was enacted prior to *Michelin* remained in effect.

All of the facts of this case were stipulated to by the parties, and such stipulation was adopted by the trial court (A. 10-24).

On March 1, 1976, Petitioner was holding certain imported goods in warehouses located in Los Angeles County and the City of Compton. Petitioner brought these goods into California for distribution throughout the United States (A. 10), to be shipped as quickly as distribution operations permitted (A. 12). The rate of turnover averaged approximately three times per year (A. 12).

Pursuant to Section 225, Petitioner claimed an exemption for the imported goods in its warehouses on March 1, 1976. Respondents denied Petitioner's claim and imposed two assessments, one in the amount of $80,381.58 by the County of Los Angeles and the City of Compton, and another in the amount of $204,142.13 by the County of Los Angeles. Petitioner paid the assessments under protest and after exhausting its administrative remedies filed suit for refund (A. 12).

At trial, Respondents urged that the property tax exemption of Section 225 applied only to imported goods in transit and not to goods (such as those in

question here) held in warehouses while awaiting shipment to other states. Respondents also asserted that Section 225 violated the Commerce Clause of the United States Constitution. The trial court held for Petitioner on both issues and granted Petitioner the refund sought, entering judgment in the amount of the two assessments plus interest (A. 52-54).

The California Court of Appeal rejected Respondents' interpretation of Section 225, but held for Respondents on the ground that the section violated the Commerce Clause of the United States Constitution. In so ruling, the court reasoned that *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), prohibited any differentiation in state taxation between foreign commerce and interstate commerce (Pet. App. 10-18).

Summary of Argument.

1. California Revenue and Taxation Code Section 225 exempts from property tax goods imported into California for shipment and sale outside the state and goods brought into California from other states for exportation. However, goods produced in California and goods brought into California from other states for shipment within the United States are not exempt from tax.

The fact that Section 225 does not exempt goods brought into California from another state to be shipped to still another state does not render the statute invalid under the Commerce Clause.

California taxes intrastate goods precisely the same as interstate goods. Such tax treatment is unobjectionable. California taxes intrastate goods less favorably than certain out-of-state goods (imports and exports).

Unfavorable treatment of intrastate goods vis-a-vis out-of-state goods is permissible under the Commerce Clause, *Alaska v. Arctic Maid*, 366 U.S. 199 (1961), and under the Equal Protection Clause, *Allied Stores v. Bowers*, 358 U.S. 522 (1959).

Favorable tax treatment of foreign goods is not prohibited by any provision of the Constitution. Historically, Commerce Clause policy has been concerned with discrimination in favor of local business at the expense of interstate commerce. Section 225 is entirely consistent with such policy. It is also consistent with the policies underlying the Import-Export Clause as articulated in *Michelin Tire. Corp. v. Wages*, 423 U.S. 276 (1976).

Moreover, *Japan Line, Ltd. v. County of Los Angeles*, ... U.S. ...., 60 L.Ed.2d 336 (1979), not only permitted but required that in certain instances foreign commerce be treated more favorably than interstate commerce. Recent Congressional enactments in the tax field consistent with California's Section 225 also reveal a favorable treatment of imports and exports over interstate goods. Internal Revenue Code Sections 4271 and 4272.

The Court of Appeal misconstrued *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), on which it relied heavily. There, New York devised a scheme which provided for a reduction in the rate of its stock transfer tax but only on the condition that the sale of the stock to be transferred also occur in New York rather than in another state, thereby benefiting stock exchanges in New York to the detriment of exchanges in other states. The Court, in striking down the New York scheme, applied classic Commerce Clause principles.

Section 225 imposes no coercive condition and is consistent with Commerce Clause principles. The California statute preserves tax neutrality between California and other free port states in a manner sanctioned by the court in *Boston Stock Exchange*.

2. The Court of Appeal held that the exemption accorded imported goods by Section 225 has the effect of offsetting tariff rates and does not give domestic manufacturers the protection from imports which Congress intended they should have. The court cited such effect as an additional reason for holding that the section violates the Commerce Clause.

In addition to California, some thirty-six states with free port laws provide for the exemption of imports shipped to other states. If the lower court's holding is correct then the laws of such states relating to the taxation of inventories of imports and domestic goods are also invalid.

Furthermore, some states completely exempt inventories or tax them at more favorable rates than those prevailing in other states. When imported goods shipped from such states compete with domestic goods subject to higher inventory tax rates, the imported goods enjoy an advantage similar to the advantage accorded imported goods by California and by the thirty-six states referred to above. There should be no difference so far as their validity is concerned between the property tax laws of a free port state and those of a state with either no inventory tax or a low rate of tax.

Such consequences are inevitable given (1) a nation composed of fifty states each having considerable autonomy, and (2) Constitutional policies ensuring the free

flow of trade among the states. These consequences can be eliminated only by requiring that all state tax laws applicable to inventories be uniform. Such a policy would destroy the principle of Federalism upon which the nation was founded.

3. No evidence was introduced to establish that Section 225 had an actual discriminatory effect upon interstate commerce. Such an effect was *assumed* by the Court of Appeal, and the statute was declared unconstitutional per se without any consideration of its effect. A per se test has been rejected by this Court in determining the validity of statutes under the Commerce Clause. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

The party attacking a statute as violative of the Commerce Clause has the burden of proving a substantial adverse effect on interstate commerce. To show that Section 225 had such an effect, several facts should have been established to demonstrate actual competition between comparable interstate and foreign goods competing in markets outside of California. Respondents made no attempt to establish any of the foregoing elements required to support their claim that the California statute is unconstitutional.

Even if a substantial adverse effect were shown to result, the California statute should not be declared unconstitutional unless it unduly burdens interstate commerce. Such a conclusion should not be reached without balancing the national interest in open trade against California's legitimate interest in exercising its taxing power.

ARGUMENT.

I

The Commerce Clause Permits California's Property Tax to Favor Foreign Commerce Over Interstate Commerce.

The instant case presents a question not heretofore decided by this Court: Does the Commerce Clause prohibit a state from according more favorable property tax treatment to imports and exports than it accords to goods produced in the state or to goods in interstate commerce?

A. The California Inventory Tax Structure.

All property in California on the tax lien date is subject to an ad valorem property tax unless such property qualifies for an exemption.[4] Section 225 exempts goods produced outside California which have a foreign origin or destination and which are held in California for shipment and sale outside the state. Goods held for sale in California are all equally subject to tax. Goods produced in other states and held temporarily in California are also subject to tax unless destined for exportation.

Thus, California's property tax system treats intrastate goods precisely the same as goods travelling in interstate commerce. It is axiomatic that such equal treatment is permissible.

B. The Constitution Permits a State to Place Local Business at a Disadvantage.

California treats intrastate goods less favorably than certain out-of-state goods, *i.e.*, imports and exports held

---

[4]California Constitution Art. XIII, § 1; Cal. Rev. & Tax. Code §§ 201, 401.3.

for transshipment. As will be discussed, unfavorable treatment of local economic interests vis-a-vis outside interests is entirely consistent with the Constitution.

The Equal Protection Clause of the Fourteenth Amendment permits a state to tax local residents less favorably than nonresidents. In *Allied Stores v. Bowers*, 358 U.S. 522 (1959), the Court considered a challenge to an Ohio statute which, in an effort to promote local warehouse business, exempted from Ohio's property tax nonresidents' property stored in Ohio warehouses. The Ohio law did not accord a similar exemption to property of residents similarly stored. Emphasizing the wide discretion afforded the states in laying taxes and the attribute of sovereignty that entitles the states to devise fiscal systems appropriate to their needs, the Court rejected the challenge and approved Ohio's statutory discrimination in favor of out-of-state residents. *Allied Stores v. Bowers*, 358 U.S. at 526-27.

In *Alaska v. Arctic Maid*, 366 U.S. 199 (1961), the Court considered the validity under the Commerce Clause of an Alaska tax statute and reached the same result as in *Allied Stores*. Under the Alaska tax system, interstate taxpayers were taxed at a rate lower than local businesses with which they competed. The Alaska tax thus favored out-of-state interests over local businesses. The Court upheld the Alaska tax, reasoning that so long as the tax on out-of-state interests "did not exceed" the tax on local competitors, no unconstitutional discrimination existed.[5]

In short, as the Court stated in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 291 (1978):

---

[5]*See also Dunbar-Stanley Studios, Inc. v. Alabama*, 393 U.S. 537, 542 (1969).

> "The Commerce Clause does not concern itself with a State's decision to place local business at a disadvantage."

C. The Commerce Clause Is Directed at Prohibiting Discrimination in Favor of Local Business at the Expense of Interstate Commerce.

There is, however, an additional element of differentiation in the California tax system that presents the novel question in this case—the more favorable treatment accorded foreign goods in relation to goods travelling in interstate commerce. Respondents would have this Court extend the Commerce Clause to invalidate this distinction. Such an extension is not warranted. Despite the unusual claim of discrimination based upon California's statutory distinction between foreign and interstate commerce, traditional Commerce Clause analysis affirms the validity of Section 225. Prior decisions of this Court which addressed the question of discrimination against interstate commerce have held that the Commerce Clause operates to prohibit the states from discriminating in favor of local business at the expense of interstate commerce. Favoritism toward local interests is the *sine qua non* of a Commerce Clause violation:

> "[I]t must be regarded as settled that no State can, consistently with the Federal Constitution, impose upon the products of other States, brought therein for sale or use, or upon citizens because engaged in the sale therein, or the transportation thereto, of the products of other States, more onerous public burdens or taxes than it imposes upon the like products of its own territory." *Guy v. Baltimore*, 100 U.S. 434, 439 (1879). *See Halliburton Oil Well Cementing Co. v. Reily*, 373

U.S. 64 (1963). *Nippert v. Richmond*, 327 U.S. 416 (1946); *I.M. Darnell & Son v. Memphis*, 208 U.S. 113 (1908); *Welton v. Missouri*, 91 U.S. 275 (1875).

D. The Boston Stock Exchange Decision Is Distinguishable From the Instant Case, Was Misconstrued by the Lower Court, and Supports the Validity of the California Statute.

The Court of Appeal's decision in the present case flies in the face of the Commerce Clause principles historically applied in cases involving allegedly discriminatory taxes. In finding that Section 225 unduly discriminated between interstate and foreign commerce, the lower court relied heavily on *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977). But the court radically misconstrued the holding of that case. Rather than precluding Section 225's differentiation between interstate and foreign commerce, the principles underlying the decision in *Boston Stock Exchange* fully support the California exemption.

The New York statute challenged in *Boston Stock Exchange* taxed transfers of securities in New York by nonresidents at one rate if the sale of the securities occurred outside New York and applied a substantially lower rate if the sale occurred in New York.[6] The use of discriminatory tax rates depending on whether the sale occurred in other states or in New York was the method or tool employed to induce nonresidents to make their stock sales in New York rather than in other states. The purpose of such discriminatory rates was to benefit the stock exchanges in New York at the expense of exchanges in other states.

[6]In the case of large transactions a lower rate of tax was available to both residents and nonresidents if the sale occurred in New York.

In an effort to uphold the scheme, the New York Court of Appeals held that a sale by a nonresident outside the state followed by a transfer in New York constituted a transaction in interstate commerce and that a sale in New York by a nonresident followed by a transfer in New York was also a transaction in interstate commerce. The New York Court of Appeals held that the statute did not discriminate against interstate commerce in favor of local commerce but rather discriminated between two kinds of interstate transactions.

This Court in effect held that it was immaterial that the discrimination involved two types of interstate commerce. In striking down the New York scheme, this Court applied classic Commerce Clause principles, *i.e.*, that a state may not discriminate against interstate commerce in order to benefit local commerce.[7] Thus this Court held that discrimination between "two types of interstate transactions in order to favor local commercial interests over out-of-state businesses . . . is constitutionally impermissible." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 335.

The Court found that New York used "its power to tax an in-state operation as a means of 'requiring [other] business operations to be performed in the home state.'" 429 U.S. at 336. New York could not have directly required that sales of New York securities

[7]*Boston Stock Exchange* has recently been cited in support of the following proposition:

> "This Court consistently has struck down state and local taxes which unjustifiably benefit local business at the expense of out-of-state business." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 288 (1978) (Powell, J., dissenting). *See also* Maltz, *The Burger Court, The Commerce Clause, and the Problem of Differential Treatment*, 54 Ind. L.J. 165, 167 (1979).

to be transferred in New York must be made in New York rather than in some other state. This Court held that the state could not endeavor to achieve the same objective through the guise of a conditional reduction of its transfer tax—a method which was essentially coercive in nature. Such a scheme prevented a nonresident from making a tax neutral choice of exchange, creating an advantage for New York exchanges and a discriminatory burden on interstate commerce.

The present case presents completely different circumstances. The unconditional exemption of imported goods is not coercive. It was not designed to benefit local business at the expense of goods in interstate commerce nor does it have any such effect. These circumstances completely distinguish this case from *Boston Stock Exchange*.

The purpose of the exemption was to encourage import business to remain in the state by creating a condition of tax neutrality as between California and various other states with free port laws. Whether or not the exemption was extended to interstate goods was completely immaterial so far as achieving this objective is concerned.

The Court of Appeal read *Boston Stock Exchange* to stand for the proposition that differential tax burdens which favor one class of commerce over another are prohibited, irrespective of any purpose or effect to advantage the home state. (Pet. App. 15). The court thereby construed *Boston Stock Exchange* as prohibiting all state differentiations between types of out-of-state commerce. But the mere existence of tax differentiation between types of out-of-state commerce, with no benefit to local interests *resulting from* such differentiation,

does not violate the Commerce Clause.[8] As this Court has repeatedly and unequivocally held, the gravamen of a Commerce Clause violation is the benefit to local business that results from differential treatment. *Boston Stock Exchange* simply reiterates and applies this rule to the unusual facts of the case. Only by misinterpreting *Boston Stock Exchange* to preclude all differentiations between out-of-state transactions could the lower court conclude that Section 225 unduly discriminated against interstate commerce. The fact is that Section 225 is a perfectly legitimate exercise of state power under the rule of *Boston Stock Exchange* and is manifestly distinguishable from the New York statute held to be invalid in that case.

In this connection the following excerpt from *Boston Stock Exchange*—which is conspicuously absent in the Court of Appeal's opinion—is noteworthy:

> "Our decision today does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other States for a share of interstate commerce." 429 U.S. at 336-37.

What California did in enacting Section 225 is precisely the kind of "structuring" to which this principle is addressed. No preference is accorded local commercial interests. It is not the differentiation in tax treatment between foreign commerce and interstate commerce which may induce import business to remain in the state. It is the fact that imported goods in

---

[8] *See Boston Stock Exchange, supra,* at 330 n. 11 suggesting that an exemption like California's would have been permissible.

California are exempt from tax. The tax differential itself—the only alleged vice of the California statute—can have no bearing on an out-of-state shipper's decision to use California's facilities. Thus, nothing in the *Boston Stock Exchange* decision supports the attack on Section 225's validity.

E. The California Statute Is Consistent With Constitutional Policies Articulated in the Michelin Decision.

Section 225 is not only consistent with underlying Constitutional policy, but even goes further than required to advance such policy. Perhaps the most comprehensive recent discussion by this Court of many of the constitutional policies relevant to the instant case was in *Michelin Tire Corp. v. Wages,* 423 U.S. 276 (1976). Although *Michelin* involved an analysis of the Import-Export Clause, it is established that the policies animating the Import-Export Clause and the Commerce Clause are much the same and that both Clauses were directed to similar concerns. *See Japan Line, Ltd. v. County of Los Angeles,* ..... U.S. ....., 60 L.Ed.2d 336, 348 n.14 (1979).

In *Michelin,* the Court dealt at length with the concerns which led the Framers of the Constitution to correct the major defects of the Articles of Confederation. The *Michelin* opinion highlighted three original concerns of the Framers: (1) The Federal Government must speak with one voice when regulating tariffs and commerce with foreign nations; (2) Import revenues should not be diverted to the states; and (3) Seaboard states should not be permitted to tax imports merely flowing through their ports to inland states to the detriment of citizens in states less favorably located. *Michelin Tire Corp. v. Wages,* 423 U.S. at 285-86.

An analysis of the concerns expressed in *Michelin* in the context of the instant case goes far to demonstrate that Section 225, by freeing imports from property tax burdens, advances each of the relevant constitutional interests. Taking these in order: (1) So long as a state forbears from imposing its property tax upon imports, as California has done in Section 225, Congress and the Federal Government are given maximum opportunity to speak with one voice to the extent necessary to regulate tariffs and foreign commerce; (2) Section 225 diverts no import revenues, directly or indirectly, to the states; and (3) Not only is California as a coastal state not taking advantage of its location at the expense of inland states, but rather it is facilitating the process of importation and exportation and thereby benefitting other states.

F. Federal Policy Encourages States to Favor Foreign Commerce Over Interstate Commerce.

The foregoing analysis demonstrates that the Constitution permits the states to give favorable treatment to imports and exports. In fact, state preferences for imports and exports have been constitutionally encouraged. Thus, in *Japan Line, Ltd. v. County of Los Angeles, supra,* the Court construed the Commerce Clause to favor foreign commerce over domestic commerce. There, the Court held that shipping containers used exclusively in foreign commerce are not subject to state property tax. However, domestic containers of the same type, when engaged in interstate commerce, are subject to state taxation. The County of Los Angeles argued in *Japan Line* that such discrimination in favor of foreign commerce and against interstate commerce is impermissible. The argument was deficient in *Japan Line* and is likewise deficient here.

In addition, recent federal legislation shows that California's exemption for imports and exports is entirely consistent with Congressional policy. The Airport and Airway Revenue Act of 1970, in order to compensate for the cost of Government services provided to air users, established a 5 percent tax on the amount paid for the transportation of property by air.[9] The Act, however, excludes from tax the transportation of imports and exports.[10]

The provisions of the federal tax on transportation of property by air are thus strikingly parallel to California's Section 225. The Federal provisions favor imports and exports by limiting the tax to domestic air transportation. Transportation of property in interstate commerce is taxed but foreign commerce is exempt. Moreover, Treasury Regulations issued under the Act provide flexible rules permitting stopovers, repackaging and consolidation of cargo in the course of movement without loss of exemption from tax.[11] California's Section 225 similarly provides that breaking in bulk, labeling, packaging, relabeling or repackaging of property is permitted without loss of exemption.

As pointed out at page 12 of the Brief for the United States supporting the Petition for Certiorari, "California's removal of property tax burdens upon imports and exports is therefore entirely consistent with congressional policy."

---

[9]Pub. L. No. 91-258. H.R.Rep. No. 91-601, 91st Cong., 1st Sess., 38 (1969).

[10]Internal Revenue Code § 4272(a).

[11]26 C.F.R. § 154.2-1(c), (d).

II

The Exemption Accorded Imported Goods Did Not Frustrate Congressional Power in Establishing Tariffs.

The Court of Appeal held that the exemption accorded certain imported goods had the effect of regulating commerce by frustrating Congressional power in establishing tariffs. The reasoning of the court apparently was that the exemption accorded imported goods had the effect of offsetting tariffs, thus reducing the amount of protection Congress intended to give domestic manufacturers (Pet. App. 15-16). If the exemption is invalid on this ground, then the property tax laws of virtually all the other states would likewise be invalid.

Each of some thirty-six other states with free port laws exempts imported goods intended for shipment to other states. Most do not extend the exemption to goods produced in the state even though destined for out-of-state shipment. Thus imported goods passing through a free port state enjoy a competitive advantage in markets in other states over (1) goods manufactured in a free port state and shipped to other states, and (2) goods manufactured and taxed in other states.

There is also a similar problem with respect to the tax laws of states which do not have free port laws. Although they do not single out imports for preferential treatment, many of such states either exempt all inventories or tax inventories at rates lower than those prevailing in other states. If goods imported into any such state remained in the state of importation and competed

only with goods manufactured there, the tax laws of such state would not operate to "offset" tariffs. But this is not the case.

The competition of imported goods is not confined to goods manufactured in the state of importation. On the contrary, imports flow through the state of importation to other states. Once an import has been shipped into another state, it there competes with locally manufactured goods as well as goods manufactured in the other states. Thus, competition will exist between goods imported, goods manufactured in such state, and goods manufactured in other states. These goods will have been subject to different states' property taxes.

To suggest that the above differences in state property taxes result in interference with Congressional power to levy tariffs is far fetched. Differences in state tax laws are a corollary of Federalism. The nation is composed of fifty states each of which within broad limits is free to structure its tax laws as it sees fit. Except by coincidence they will not be precisely alike. The free flow of trade among the states and with foreign countries is also an attribute of Federalism. Therefore it is inevitable that consequences such as those discussed will occur.

Many differences among states' tax laws have long existed. It must be assumed that Congress was aware of such differences and adjusted tariffs accordingly or, more likely, ignored them.

In the overall context of the tariff making process, state property taxes are at most a minor item in the determination of manufacturing costs throughout the United States. Like California, most states impose a tax only on goods in the state on the state's tax

date—one day out of 365. As a result only a fraction of the total goods in the state during any given year are actually taxed.

During the year at issue in the instant case, 1976, the California tax rate on the market value of property varied between 3 and 3½%. A 50% exemption for inventories reduced the tax rate to 1½ to 1¾%.[12] In the case of the goods in question there was a turnover rate of three times per year, resulting in an average effective rate of tax of as little as ½%. (A. 12). Thus. even if there were some merit to the Court of Appeal's holding regarding frustration of Congressional power, the effect of the exemption in question was *de minimis*.

III

The California Statute Should Be Upheld Because No Impermissible Effect Upon Commerce Has Been Established.

A. The Lower Court Erroneously Applied a Per Se Test in Determining the Statute's Constitutionality.

No effort was made by Respondents to establish that the California statute had an actual discriminatory effect upon interstate commerce. The court below treated the statute as invalid on its face, thereby applying a *per se* test in determining the statute's constitutionality.[13] Thus, without any evidence on the subject. the court assumed that an unconstitutional effect existed.

[12]Cal. Rev. & Tax. Code § 219.

[13]The Court of Appeal assumed that since the statute accorded goods different tax treatment on the basis of their origin, "Foreign goods are thereby given a competitive advantage over interstate goods of the same nature and competing in the same market." (Pet. App. 11).

In this respect, the Court of Appeal was in error. This Court has rejected a *per se* test in determining the validity of statutes under the Commerce Clause. Earlier decisions suggested that state tax statutes might be invalidated on Commerce Clause grounds without considering their practical operation and effect. For example, in *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602 (1951), the Court held invalid a state franchise tax on the ground that the tax was imposed upon the privilege of engaging in interstate commerce. The *Spector* approach deemed "irrelevant any consideration of the practical effect of the tax."[14]

In declaring the California statute unconstitutional, the Court of Appeal essentially followed the anachronistic *Spector* approach. The court held that the differentiation on the face of the statute between interstate and foreign commerce was *per se* unconstitutional and required no evidence whatsoever of the practical effect of the statute.

The *Spector* approach adopted by the Court of Appeal has been rejected by this Court. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977). In *Complete Auto,* the Court upheld the validity of a tax similar to that stricken in *Spector* after considering its practical operation and effect:

> There is no economic consequence that follows necessarily from the use of the particular words [of the statute] and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect. . . . Accordingly, we now reject the rule of Spector Motor Service,

[14]*Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 278 (1977).

> Inc. v. O'Connor, that a state tax on the "privilege of doing business" is per se unconstitutional when it is applied to interstate commerce, and that case is overruled.[15]

In order to determine the validity of the California statute it is necessary to consider the effect the statute has upon interstate commerce. It would be an exercise in formalism to declare the statute unconstitutional based on speculative concerns of burdening interstate commerce. *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 280. The burden of proving that the statute has an unlawful effect rests upon Respondents, the parties attacking the statute.[16]

B. Respondents Failed to Establish That the Statute Has Any Effect on Interstate Commerce.

The potential effect of the California statute which the Court of Appeal assumed to be present is that the different tax treatment accorded foreign and domestic goods originating outside California and traveling through California to destinations outside the State could result in the foreign goods having "a competitive

[15]*Id.* at 288. More recently, the Court scrutinized the practical operation of a state tax statute attacked as discriminatory in *First Federal Savings and Loan Association v. State Tax Commission,* 437 U.S. 255, 259 (1978), and upheld the tax, holding that the federal savings and loan associations attacking the statute:

> [H]ave not, however, established that it is unfairly burdensome in "practical operation." The record does not indicate that federal associations have *suffered* a *significant handicap* in competing with state institutions, or that any other federal policies have been thwarted. (Emphasis added.) (Citation omitted.)

[16]*Metropolitan Casualty Ins. Co. v. Brownell,* 294 U.S. 580, 584 (1935); *Brown v. Maryland,* 25 U.S. (12 Wheat.) 262, 263 (1827).

advantage over interstate goods of the same nature and competing in the same market." (Pet App. 11). This, however, was a gratuitous assumption on the part of the lower court. There is no evidence in the record whatsoever to support it.

In order to show such an adverse effect on competition by interstate goods in the markets of other states, it would be necessary at a minimum to prove each of the following factors: (1) There must be a volume of traffic in goods brought into California from other states for shipment out of the state in interstate commerce; (2) Such interstate goods must be comparable to foreign goods similarly brought into California for shipment out of the state; (3) The interstate goods must be subjected to California property tax and the foreign goods must be exempted from such tax by reason of Section 225;[17] (4) The interstate and foreign goods must be shipped to markets in other states where they compete against each other.

No evidence was offered to prove any of the foregoing factors. The claimed discriminatory effect on competition is therefore hypothetical and speculative.

---

[17]There are a number of reasons for believing that interstate as well as foreign goods may never become subject to California property tax. As the Court pointed out in *Michelin Tire Corp. v. Wages*, 423 U.S. at 288, state property taxes on goods can easily be avoided by the use of modern methods of transportation such as air freight, containerized packaging and railroads. In addition, it is common knowledge that merchants have for years avoided the property tax by letting their inventories become depleted shortly before a given tax date and then replenishing them shortly thereafter. *See* Keesling, *Michelin Tire Corporation v. Wages: The Demise of the Original Package Doctrine*, 50 So. Cal. L. Rev. 719, 725 (1977).

Even if these factors are assumed to exist, they would not establish the extent of the effect, if any, on commerce.[18] At most, the effect of the tax on competition in the markets of other states would be highly attenuated.

C. The Effect of the Statute, if Any, Is too Insubstantial to Place an Undue Burden on Interstate Commerce.

Assuming *arguendo* the existence of an effect on competition, the question remains whether such effect requires invalidation of the exemption under the Commerce Clause. At most, the policies of California may have resulted in a slight ripple effect on competition in markets outside of California. Respondents must show that the California exemption has a substantial effect which places an undue burden on interstate commerce.[19] The imposition of an ad valorem property tax such as that involved in *Michelin* has been characterized by the Court as having an insubstantial effect on the demand for the goods so taxed. *Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 753 (1978).

Furthermore, even assuming a substantial adverse effect on commerce, in order to determine whether this constituted an undue burden it would be necessary

---

[18]The extent of the effect was *de minimis*. See text accompanying footnote 12, *supra*.

[19]*Nippert v. Richmond*, 327 U.S. 416, 424 (1946). *See also Gregg Dyeing Co. v. Query*, 286 U.S. 472, 481 (1932):

> "Discrimination, like interstate commerce itself, is a practical conception. We must deal in this matter, as in others, with substantial distinctions and real injuries."

to make "the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers."[20] This determination requires an examination of "the unique characteristics of the statute at issue and the particular circumstances in each case."[21]

No such characteristics or circumstances were considered by the Court of Appeal. In light of the history, purpose and background of the statute,[22] its attenuated and problematic effect on commerce, and the lack of any precedent for an extension of the Commerce Clause to invalidate any such effect, Section 225 should be upheld.

---

[20]*Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318, 329 (1977). "*Complete Auto* recognized that a state has a significant interest in exacting from interstate commerce its fair share of the cost of state government." *Department of Revenue v. Association of Washington Stevedoring Cos.,* 435 U.S. at 748.

[21]*Boston Stock Exchange v. State Tax Commission,* 429 U.S. at 329.

[22]The statute providing for the exemption in question was enacted in 1975 and became effective while the original package doctrine was still in effect. Notwithstanding the Constitutional immunity then accorded imports, it was well established that the state could tax other goods, including goods in their original packages, brought into the state from other states. Thus, there is little question but that the statute was valid at the time enacted. *Cf. First Federal Savings and Loan Association v. State Tax Commission,* 437 U.S. 255 (1978). The Legislature in enacting the statute involved was not displaying an unfriendly discriminatory attitude toward interstate commerce, but was simply following a pattern which had existed from time immemorial. Even after the decision of this Court in *Michelin* the different tax treatment of goods in interstate commerce was not due to any deliberate attempt or unfriendly attitude on the part of the California Legislature, but rather was due to the passive continuation of the *status quo ante* with respect to goods brought in from other states.

Conclusion.

For the reasons set forth herein, the opinion of the California Court of Appeal, Second Appellate District, should be reversed.

Respectfully submitted,

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
Attorneys for Petitioner.

THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

EXHIBIT A.

Ala. Code tit. 40, § 40-9-6 (1975)

Ariz. Rev. Stat. §42-631 (1956), Ariz. Rev. Stat. §42-632 (Supp. 1957-1978)

Ark. Stat. Ann. §84-417 (Supp. 1979)

Cal. Rev. & Tax Code §225 (West Supp. 1979)

Colo. Rev. Stat. §§39-1-102, 39-1-104 (1973)

Conn. Gen. Stat. §§12-95a, 12-108 (1979)

D.C. Code §47-641 (Supp. 1978), D.C. Code §47-1204 (1973)

Fla. Stat. §196.0011 (1977)

Ga. Const. of 1976, art. VIII, §I, para. IV

Idaho Code §§63-105 W, 63-105 X (1976)

Rev. Act of 1938 §19.21, Ill. Rev. Stat. ch. 120, §500.21 (1977)

Ind. Code §§6-1.1-10-29, 6-1.1-10-30, 6-1.1-10-30.5 (Supp. 1978)

Iowa Code §§ 427.1, 427.16 (1975)

Kan. Stat. §79-201f (1977)

Ky. Rev. Stat. §132.095 (1970)

La. Const. of 1974, art. 7, §21

Me. Rev. Stat. Ann. tit. 36, §655 (West 1978)

Mass. Ann. Laws ch. 59, §2 (Michie/Law. Co-op 1978)

Mich. Comp. Laws Ann. §211.9 (Supp. 1979-1980)

Miss. Code Ann. §27-31-13 (1972)

Mo. Rev. Stat. §137.093 (1969)

Mont. Rev. Codes Ann. §84-202(4) (Supp. 1977)

Neb. Rev. Stat. §77-1226.01 (Supp. 1978)

Nev. Rev. Stat. §§361.160, 361.163, 361.165 (1977)

N.J. Stat. Ann. §54:4-3.20 (West 1960)

N.M. Stat. Ann. §§ 7-36-7, 7-36-14 (1978)

N.C. Gen. Stat. §105-275 (Supp. 1977 & Supp. 1978)

Ohio Rev. Code Ann. §5701.08 (Page 1973)

Okla. Stat. Ann. tit. 68, §2425 (West Supp. 1978-1979)

Or. Rev. Stat. §§307.801, 307.820, 307.830, 307.840, 307.850, 307.990 (1977)

S.C. Code §§12-37-1110, 12-37-1120, 12-37-1130, 12-37-1140, 12-37-1150 (1976)

S. D. Compiled Laws Ann. §10-4-28 (1967)

Tenn. Code Ann. §67-5180 (1976)

Tex. Rev. Civ. Stat. Ann. art. 7150 f (Vernon Supp. 1978-1979)

Utah Code Ann. §§59-2-18, 59-2-19 (1973)

Wis. Stat. §70-111(10) (1977)

Wyo. Stat. §39-1-201 (1977)